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Bank Otkritie and Binbank: Was There an Option Other Than Bailout

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3. BANK OTKRITIE AND BINBANK: WAS THERE AN OPTION OTHER THAN BAILOUT?

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Some of Russia’s big private banks were faced with the risk of banking license revocation in August–September 2017. The financial resolution of Bank Otkritie and of Binbank was implemented using a new mechanism – The Fund for Banking Sector Consolidation.

The selected resolution option by putting the money of the state-owned entity called The Fund for Banking Sector Consolidation directly into rescued banks can be regarded under the circumstances as optimal solution given that the Russian central bank has gained a 3-year experience in financial resolution of banks (license revocation and reimbursement of insured bank deposits out of The State Agency for Deposit Insurance (SADI), SADI-assisted financial resolution of banks, other banks assistance in resolution of rescued banks). In this particular case, the selected option is first of all based on the size of banks. Banking license revocation could have caused a bank run, which is not affordable for SADI: The Deposit Insurance Fund has been almost fully depleted over the past 1.5–2 years, and new bank contributions to the deposit insurance framework are insufficient to reimburse the insured deposits in banks faced with license revocation. Such reimbursements are currently financed through Bank of Russia’s loans that are also used for solvency recovery procedures. However, such procedures tend to cost more than reimbursement of insured deposits. Regarding other banks assistance in resolution of rescued banks, any bank’s involvement in the resolution of Binbank or Bank Otkritie would have encountered serious challenges amid a stagnating market, that is, regulator assistance would have been required again.

Bailing out big systemic banks or financial corporations faced with the risk of default has become a common international practice since the crisis of 2008: there are few examples including AIG in the USA, four of the five big private banks in the UK, Credit Agricole in France, etc. This is a new trend facing the international practice of dealing with banking crises (by contrast, the previous most common practices involved the deposit insurance framework and sale of bankrupt banks to strong private players) that has emerged because of increasingly high risk of bank losses, systemic implications and a lack of banks amid crisis that are reliable enough so that the regulator can be sure they will not run the risk of default after assuming the liabilities of bankrupt banks. In this context, increasingly strong participation of the state in the banking sector is considered as a provisional measure.

Furthermore, crisis-driven situations have largely contributed to systemwide imperfection of the banking supervision principles in force, particularly the applicable Basel requirements that prevent banks from disguising problems amid inflation-driven growth of nominal balance-sheet values, the applicable credit restructuring procedure, and the existing framework of prudential standards. This is a global issue facing the prudential supervision that will be solved in part after a complete transition to the Basel III framework.

Note, however, that owners and managers of Russian rescued banks enjoyed...
support of the Russian government and of the central bank: including direct loan-based support and approvals of business expansion through acquisition of new companies as well as involvement in financial resolution of other banks, thereby encouraging their misbehaviour. However, had it not been for a drastic inflation deceleration, these banks could have most likely stayed solvent for long enough and might have possibly “lived to” recovery from stagnation in the bank lending market and to the onset of steady economic growth.

Bank recap directly via the central bank (The Fund for Banking Sector Consolidation (FBSC) rather than through the federal government (out of the federal budget) is, on the one hand, reasonable due to the central bank’s status as a mega regulator of the banking sector and of the financial market (this function would be more reasonable for the central government if such policy, as applied to non-financial companies, is inevitable and recognized as optimal). On the other hand, it is the central bank as monetary regulator that can minimize inflationary risks that may arise from a big money-printing to help rescued banks stay solvent. The central bank can consider the size and the time of money-printing when estimating the daily structural liquidity surplus/deficit in the banking sector. Correction is therefore may be applied to the size of Bank of Russia’s other liquidity provision/absorption operations that intend to offset the money-printing in support of banks. For instance, the size of liquidity surplus is currently almost in line with the values which were anticipated earlier in the year by the Russian central bank and intended to lead to the 4% target inflation. The liquidity via the federal budget channel has turned out to be less than expected, thereby allowing the Bank of Russia to increase lending to the banking system with no material changes in banks’ projected liquidity. The Russian central bank keeps all the tools required to ensure that the key interest rate is in line with the target. Indeed, should there be additional net money-printing, the Russian central bank would have to, all other things being equal, maintain the key rate at a slightly higher level. However, should systemic issues occur in the banking system, macroeconomic implications would be far more serious.

The financial resolution of Binbank and Bank Otkritie is an explicit evidence of the Bank of Russia’s intention to rescue the banks, not their owners. The owners have actually lost their interest in the banks after consolidation with the FBSC. In other words, the money has been given on a repayable basis, albeit no bonds have been issued, if we assume (according to the aforementioned new international practice) that the state’s participation, via the central bank, in the banks’ capital is provisional. Note that the money’s repayable nature, i.e. the redemption of the money printed for the bank recap purpose, will be secured even if a state-owned bank (Sberbank, VTB) repurchases the FBSC interest, in which case the money that the banks are holding on the correspondent accounts with the central bank will be written off, and therefore the monetary base will shrink.

The issue of banking supervision reform is to be addressed in the medium term because it is the imperfect banking supervision that is largely responsible for the situation facing this sector. The reform should pursue at least two goals. The goal number one is adequate optimization of bank costs on coordination with the regulator as part of the supervisory function. The heavy regulatory burden on the banking sector is market players’ long-standing, well-grounded complaint. Efforts should be made in order to organize the
entire array of bank reporting, prevent duplication within the reports submitted to the Bank of Russia and within the reporting forms submitted to other government agencies.

The goal number two, which is closely connected with the goal number one, is to increase the effectiveness of regulator’s control over banks’ financial standing. Not only does excessive reporting increase bank costs, but it also impedes inspection authorities’ control over bank status, allowing information to be manipulated to one’s own benefit.

Both goals can in part be achieved by introducing a framework of electronic online interaction between banks and the regulator. Banks will therefore be able to limit themselves to one-off submission of any reporting information. In the meantime, representatives of regulator’s various entities will have constant access to all the relevant information about the bank and will be able to monitor regulated entities on an online basis.

The introduction of the new framework will likely require substantial, albeit one-off, costs. In addition, a certain period of transition may be required, during which the supervisory burden on banks may increase because both the old and the new reporting frameworks will stay in force.